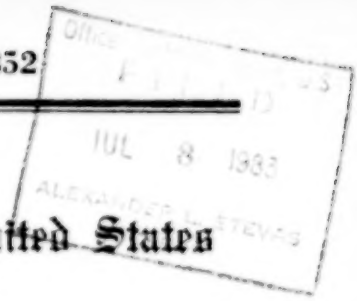
NOS. 82-818 and 82-852



IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

NATIONAL LABOR RELATIONS BOARD, PETITIONER (82-818)

v.

BILDISCO AND BILDISCO, DEBTOR-IN POSSESSION, ET AL.

AND

LOCAL 408, INTERNATIONAL BROTHERHOOD OF TEAMSTERS, CHAUFFEURS, WAREHOUSEMEN AND HELPERS OF AMERICA, PETITIONER (82-852)

v.

NATIONAL LABOR RELATIONS BOARD, ET AL.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR RESPONDENTS, BILDISCO AND BILDISCO, DEBTOR IN POSSESSION

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Questions Presented

1. Whether the standard formulated by the Court of Appeals for rejection of a collective bargaining agreement by a Chapter 11 trustee or debtor in possession, under which the bankruptcy court is required to balance the competing equities, is appropriate and proper.

2. Whether a debtor in possession is obligated to comply with the bargaining requirements for midterm contract modification contained in Section 8(d) of the National Labor Relations Act, 29 U.S.C. 158(d), as a precondition to seeking bankruptcy court authorization to reject a collective bargaining agreement.

3. Whether a debtor in possession may be found to have committed an unfair labor practice by unilaterally changing the terms and conditions of employment in the period between the filing of a Chapter 11 petition and the entry of an order permitting rejection of a collective bargaining agreement.

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BRIEF FOR RESPONDENTS, BILDISCO AND BILDISCO, DEBTOR IN POSSESSION

Statutory Provisions Involved

Respondents believe that in addition to the statutory provisions set forth in Petitioners' brief, resolution of this case involves consideration of other portions of Section 365 of the Bankruptcy Code, 11 U.S.C. §365. The pertinent provisions of this statute provide:

> "§365. Executory contracts and unexpired leases.
>
> (a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
>
> (b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—
>
> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> (C) provides adequate assurance of future performance under such contract or lease.
>
> (2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—
>
> (A) The insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession of a trustee in a case under this title or a custodian before such commencement.

(3) For the purposes of paragraph (1) of this section, adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—

(A) of the source of rent and other consideration due under such lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease will not breach substantially any provision, such as a radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt substantially any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The Trustee may not assume or assign an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from excepting performance from or rendering performance to the trustee or an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegations of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

• • •

(g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, or 13 of this title, immediately before the date of the filing of the petition;"

Counter-Statement of the Case

On April 14, 1980, Bildisco, a New Jersey general partnership, filed a voluntary petition for reorganization pursuant to Chapter 11 of Title 11 of the United States Code. The bankruptcy court subsequently authorized Bildisco to operate its business as a debtor in possession.

At the time of the Chapter 11 filing Bildisco was a party to a collective bargaining agreement with Local 408 of the Teamsters Union (hereafter "the Union"). In December of 1980 Bildisco filed an application with the bankruptcy court pursuant to 11 U.S.C. §365(a) for an order authorizing it to reject the collective bargaining agreement.

On January 5, 1981 the bankruptcy court conducted a hearing on Bildisco's application. The sole witness at the hearing was Salvatore Valente, one of Bildisco's general partners. Mr. Valente testified that by operating without the labor contract his company would be able to save approximately $100,000 in 1981. Other than cross-examining Mr. Valente, the Union offered no evidence to refute his testimony or to demonstrate the consequences of rejection on the three union employees still on the debtor in possession's payroll at the date of the hearing.

On January 15, 1981, the bankruptcy judge entered an order authorizing the debtor in possession to reject the collective bargaining agreement. On appeal the district court affirmed the bankruptcy court order. The Union thereupon lodged an appeal to the United States Court of Appeals for the Third Circuit.

On July 31, 1980, the General Counsel of the National Labor Relations Board (hereafter "the Board" or "the NLRB") filed a complaint against Bildisco. The complaint alleged that Bildisco and Bildisco, debtor in possession, had violated 29 U.S.C. §§158(a)5 and (a)(1) by unilaterally changing existing terms and conditions of employment. Specifically, it was alleged that Bildisco and Bildisco, debtor in possession, had failed to make required pension, health and welfare contributions, to remit union dues and to pay wage increases provided for in the collective bargaining agreement. An amended complaint was issued on October 8, 1980.

On January 27, 1981, twelve days after the bankruptcy court authorized rejection of the labor agreement, the General Counsel filed a motion for summary judgment based upon Bildisco's failure to file an answer to the complaint.

On February 9, 1981 the Board issued an order to show cause why summary judgment should not be granted. Bildisco filed a response to the order to show cause informing the Board of the entry of the bankruptcy court order authorizing rejection of the collective bargaining agreement. The response noted that under the Bankruptcy Code rejection of the collective bargaining agreement was retroactive to the date of the filing of the Chapter 11 petition, and that, based upon the bankruptcy court's order, no labor agreement existed after April 14, 1980. Bildisco

further argued that any monetary obligations arising from the failure to make contributions prior to the Chapter 11 filing were properly to be treated as claims subject to allowance in the reorganization proceedings.

On April 23, 1981, the Board granted the motion for summary judgment finding "as a matter of fact" that the debtor in possession was the alter ego of the pre-chapter 11 company. The Board's order directed the debtor in possession to cease and desist from refusing to bargain and pay the contributions, remitances and wage increases provided for in the labor agreement. Despite its notification that the bankruptcy court had authorized rejection of the union contract, the Board made no mention of this fact nor explained why, in its view, it was free to order the debtor in possession to comply with the contract despite the entry of a federal court order directly to the contrary. The NLRB applied to the Third Circuit for enforcement of its order which application was consolidated with the union's appeal.

The court of appeals concluded that collective bargaining agreements are executory contracts subject to rejection under 11 U.S.C. §365(a). The court also held, however, that given the public policy favoring collective bargaining agreements the courts should apply a more stringent standard to applications to reject such agreements than is normally applied to other types of executory contracts. In place of the business judgment test, under which a debtor in possession will be allowed to reject a collective bargaining agreement upon a mere showing that rejection will benefit the bankrupt estate, the court formulated a standard which imposes a double burden on the debtor in possession. First, the debtor in possession must demonstrate that the collective bargaining agreement is burdensome to the estate. Once this requirement has been satisfied,

the debtor in possession must make a factual presentation sufficient to permit the court to conclude that the competing equities weigh in favor of rejection. Because in its view the bankruptcy court had failed to adequately articulate the basis for its decision to allow rejection, the court remanded for reconsideration in light of the standards it had formulated.

The court also refused to enforce the Board's order. Rejecting the Board's conclusion that a debtor in possession is merely the alter ego of the pre-bankrupt company and relying upon prior decisional law, the court held that a debtor in possession is a new entity and thus not a party to nor bound by the substantive terms of an existing collective bargaining agreement.

The court further held that rejection of an executory contract relates back to the date of the filing of the Chapter 11 petition. If on remand the bankruptcy court again permits rejection, the Board will be foreclosed from finding that the debtor in possession's failure to comply with the terms of the agreement constituted an unfair labor practice, since no agreement was in effect subsequent to the date of the Chapter 11 petition.

Summary of Argument

1. The balancing of the equities test formulated by the court below to govern applications by Chapter 11 trustees or debtors in possession to reject collective bargaining agreements recognizes and protects the interests of unionized employees by requiring the bankruptcy court to consider the impact of rejection on employee rights in light of the favored status of these rights as expressed in the NLRA. The Third Circuit's test also recognizes that protection of employee rights should not be elevated

to the point where it prevents a debtor in possession from continuing its business and restructuring its finances in a manner fair and equitable to all of its creditors. The court's standard thus successfully accommodates the policies of labor protection and business rehabilitation.

The test advocated by Petitioners, under which a debtor in possession would be permitted to reject a collective bargaining agreement only if it could demonstrate that compliance with its terms would result in liquidation, is not supported by the language of the Bankruptcy Code and is inconsistent with fundamental bankruptcy policy which requires equitable treatment for all creditors.

In most Chapter 11 cases the ability of a debtor in possession to implement a plan of reorganization cannot be accurately predicted until well after the filing of the petition. At least in the early stages of a proceeding, therefore, a debtor in possession will be unable to demonstrate to a certainty that adherence to a collective bargaining agreement will cause its collapse. By the time this fact does become clear it may be too late to stave off a liquidation with the resulting loss of all of the employees' jobs.

Unionized employees are far from powerless to protect their interests even when a labor agreement is rejected. The union remains their bargaining representative and the debtor in possession is required to negotiate with respect to new terms and conditions of employment. The employees are free to strike should negotiations fail. The employees also have the right to file claims for damages arising from the rejection of the collective bargaining agreement and to assert priority administration claims for the fair market value of services provided to the debtor in possession prior to rejection.

2. The Third Circuit properly rejected the Union's contention that a debtor in possession must comply with the requirements of Section 8(d) of the NLRA governing midterm modifications of collective bargaining agreements before seeking permission to reject a collective bargaining agreement. The Court's holding that a debtor in possession is a new entity not bound by the terms and conditions of the pre-Chapter 11 entity's labor agreement is consistent with both the fiduciary status of a debtor in possession under the Bankruptcy Code and with decisional law holding that the filing of a Chapter 11 petition frees the debtor in possession from performing its obligations under an executory contract unless such contract is affirmatively adopted.

The Union's position that a debtor in possession is bound by a collective bargaining agreement and cannot seek rejection until it has complied with the time-consuming requirements of Section 8(d) would force a debtor in possession to comply with all of the terms of a collective bargaining agreement, no matter how financially onerous, while at the same time preventing it from seeking prompt approval to disaffirm the agreement. Placing a debtor in possession in this position would undoubtedly redound to the detriment of the employees themselves by forcing numerous companies into liquidation before they are unable to obtain an order authorizing rejection.

The analogy drawn by the Third Circuit between a debtor in possession and a successor employer is persuasive. The policy of fostering the resuscitation of financially moribund businesses underlying the freedom of a successor employer to set initial terms and conditions of employment is especially compelling in the case of a debtor in possession. In the legal context of a Chapter 11 proceeding, moreover, a debtor in possession

cannot be deemed to have adopted the pre-bankruptcy company's collective bargaining agreement by its conduct since adoption can only result from a court order.

3. The Board's theory that a debtor in possession is the alter ego of the pre-Chapter 11 company and commits an unfair labor practice by changing the terms and conditions of employment suffers from the same defects as the Union's assertion that a debtor in possession is required to comply wilth Section 8(d) of the NLRA. A debtor in possession, far from being the alter ego of the pre-bankruptcy company, is a fiduciary granted new rights and charged with operating its business for the benefit of its creditors subject to control and review by the bankruptcy court.

A debtor in possession, as a matter of well-settled case law, is not obligated to perform under an executory contract unless and until the contract is adopted with the approval of the bankruptcy court. Moreover, if an executory contract is rejected, the rejection relates back to the date of the Chapter 11 petition. The debtor in possession is relieved of all contractual liabilities arising subsequent to the filing of the Chapter 11 petition.

This conclusion is emphasized by the case law holding that in the event of rejection the other party to the agreement is entitled to fair compensation for benefits conferred upon the estate subsequent to the Chapter 11 filing. This right is founded upon equitable principles akin to *quantum meruit*, however, and not upon the contractual liabilities specified in the contract.

The Board's assertion that a debtor in possession is bound by the terms of a labor agreement until it is dis-

affirmed subverts the basic policy underlying the whole doctrine of rejection. The courts and Congress have historically recognized that a debtor in possession must be given a reasonable period of time in which to determine whether an executory contract is beneficial or burdensome. During this period it is not required to perform under the contract. Requiring the debtor in possession to comply with the terms of an executory contract prior to its decision to adopt or reject it would shackle the estate with the precise obligations Section 365 is designed to remove. Moreover, the debtor in possession's ability to evaluate the impact of the collective bargaining agreement on its operation would be undermined by the financial burdens imposed by the agreement.

Because rejection of a collective bargaining agreement is retroactive to the commencement of the Chapter 11 proceedings, an order permitting rejection is in effect a determination that the agreement termin. 'ed as of the date of the petition. The Board therefore is precluded from finding that the debtor in possession's failure to adhere to its terms constituted an unfair labor practice.

POINT I

The balancing of the equities test formulated by the Court below to govern applications by Chapter 11 trustees or debtors in possession to reject collective bargaining agreements successfully accommodates the competing public policies embodied in the National Labor Relations Act and Chapter 11 of the Bankruptcy Code.

The decision of the court below represented the first instance in which a court of appeals addressed the standard to be applied in considering whether a Chapter 11 debtor in possession or trustee should be permitted to reject a collective bargaining agreement pursuant to Section 365(a) of the Bankruptcy Code.[1] The court recognized that this issue required the accommodation of the competing policy goals of labor protection, as embodied in the National Labor Relations Act ("NLRA"), and of business rehabilitation, as expressed in Chapter 11 of the Bankruptcy Code. It therefore held that applications to reject labor agreements must be subject to a more stringent standard than that applied to other categories of executory contracts.

Generally, a debtor in possession may disaffirm an executory agreement if it can satisfy the business judg-

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[1] Although not defined in the Bankruptcy Code, an executory contract is generally understood to include any contract on which performance remains due to some extent on both sides. House Report No. 95-595, 95th Cong., 1st Sess. 347 (1977); Senate Report No. 95-989, 95th Cong., 2nd Sess. 58 (1978). Both the Union and the Board concede that a collective bargaining agreement is an executory contract subject to rejection pursuant to Section 365(a).

ment test which requires only a showing that rejection will benefit the estate. See 2 *Collier on Bankruptcy*, ¶365.03 (15th ed.).[2] The court of appeals ruled, however, that the favored status of union employees, as recognized in Sections 7 and 8 of the NLRA, 29 U.S.C. §§157 and 158, rendered the business judgment test inappropriate in considering applications to reject collective bargaining agreements.

Under the standard formulated by the Third Circuit, a debtor in possession seeking to reject a labor agreement must make a threshold showing that the contract is burdensome to the estate. Once this initial burden is satisfied, the debtor in possession must present facts sufficient to demonstrate to the court that the competing equities tip in favor of rejection.

In weighing the equities, the bankruptcy court is required to give consideration to the rights of unionized employees as expressed in the national labor policy. The court must also consider the claims and interests of the debtor's other creditors and make a reasoned determina-

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[2] While Section 365(a) refers to a trustee's right to reject executory contracts, a debtor in possession may exercise this right pursuant to Section 1107(a) of the Bankruptcy Code, 11 U.S.C. §1107(a), which provides:

> "Subject to any limitations on a trustee under this chapter and to such limitations or conditions as the court prescribes, a debtor in possession shall have the rights, other than the right to compensation under Section 330 of this title, and powers, and shall perform all the function and duties, except the duties specified in Sections 1106(a)(2), (3) and (4) of this title, of a trustee serving in a case under this chapter."

tion that rejection of the labor contract will assist in the achievement of a satisfactory reorganization.

Despite the explicit recognition of the favored status of unionized employees and the substantial measure of protection given employee rights in the Third Circuit's formulation, the Petitioners argue that this carefully balanced approach fails to go far enough to protect the interests of organized labor. Both the Union and the Board urge upon this Court a standard under which a collective bargaining agreement cannot be rejected absent a showing that a failure to permit rejection will inevitably result in the liquidation of the debtor. Such a test, however, is contrary to the letter and spirit of the Bankruptcy Code, unduly promotes the interests of unionized employees over the interests of the debtor's other creditors, and goes well beyond what is rationally required to balance the competing policies of the Bankruptcy Code and the NLRA. In addition, as the court below noted, the difficulty of predicting the prospects for reorganization during the early stages of a Chapter 11 proceeding renders the test espoused by petitioner unworkable. The evidentiary burden this test would impose on a debtor in possession is, moreover, likely to work to the dertiment of employees by forcing numerous enterprises into liquidation.

In enacting Section 365, Congress did not single out collective bargaining agreements for special treatment. This omission is significant in view of the detailed exceptions to and conditions on rejection or assumption of specific types of executory contracts such as commodity futures contracts and shopping center leases.

Moreover, in Section 1167 of the Bankruptcy Code Congress explicitly restricted the right of a debtor in possession or trustee to reject labor agreements governed

by the Railway Labor Act ("RLA").[3] Its failure to enact similar restrictions on rejection of agreements covered by the NLRA leads to the logical conclusion that Congress intended such agreements to be treated in a manner similar to other executory contracts.

The Union and the Board attempt to read into Congressional silence a tacit codification of the holding in *Brotherhood of Railway Airline and Steamship Clerks* v. *REA Express, Inc.*, 523 F.2d 164 (2d Cir.) *cert. denied*, 423 U.S. 1017 (1975), which adopted a standard for rejection of labor agreements under Section 313(1) of the former Bankruptcy Act, former 11 U.S.C. §713(1), similar to that advocated by petitioners.[4] This attempt, however, does not withstand analysis. Petitioners argument is premised upon the holdings in *Lorillard* v. *Pons*, 434 U.S. 575 (1978), *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979) and *NLRB* v. *Gullet Gin Co.*, 340 U.S. 361 (1951). These cases hold that by reenacting a

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[3] Section 1167 provides:

> "Collective bargaining agreements. Notwithstanding section 365 of this title, neither the court nor the trustee may change the wages or working conditions of employees of the debtor establshied by a collective bargaining agreement that is subject to the Railway Labor Act (45 U.S.C. 151 et seq.) except in accordance with section 6 of such Act (45 U.S.C. 156)."

[4] Section 313(1) of the former Bankruptcy Act provided:

> "Upon the filing of a petition, the court may, in addition to the jurisdiction, powers and duties hereinabove and elsewere in this chapter conferred and imposed upon it—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties of such contracts and to such other parties in interest as the court may designate."

statute without substantial change Congress is generally deemed to have codified existing case law interpreting the statute.

A comparison of former Section 313(1) and Section 365 reveals that the present section is fundamentally different from its predecessor. Fleshing out the bare bones of the former provision, Congress included an extensive list of exceptions to the trustee's power to reject, assume or assign executory contracts. Section 365 is clearly the product of careful Congressional analysis of the issue of assumption and rejection rather than a reenactment without substantial change. No inference can therefore be drawn that Congress intended to codify decisional law concerning the rejection of collective bargaining agreements under former Section 313(1).

Prior to the enactment of the Bankruptcy Reform Act of 1978 only one circut court of appeals had addressed the standard governing rejection of a collective bargaining agreement by a trustee or debtor in possession. In *Shopmen's Local Union No. 455* v. *Kevin Steel Products, Inc.*, 519 F.2d 698, 707 (2d Cir. 1975), decided in July, 1975, the Second Circuit held that permission to reject collective bargaining agreements should be granted "only after thorough scrutiny, and a balancing of the equities on both sides."

In August, 1975, the Second Circuit decided the case of *Brotherhood of Railway Airline and Steamship Clerks* v. *REA Express, Inc., supra,* which involved the right of a debtor in possession to reject a labor agreement governed by the Railway Labor Act, 45 U.S.C. §151 *et seq.*

Without explicitly explaining its reasons for apparently diverging from the balancing of the equities standard, which it had articulated the previous month in *Kevin Steel,* the court declared that rejection should be permitted only

if it can be clearly demonstrated that absent rejection the debtor will collapse and the employees will be without jobs. (*id.* at 172).

The failure of Congress to codify the *REA Express* standard, despite its extensive revision of the law relating to executory contracts, argues strongly for the conclusion that Congress did not intend that the *REA* test would control cases decided under Section 365. Moreover, while overlooked by Petitioners and indeed by the district and bankruptcy courts which have followed and expanded the decision in *REA Express,* that case did not involve a collective bargaining agreement subject to the NLRA, but rather an agreement subject to the RLA. In *Kevin Steel, supra* at 705, the Second Circuit had itself noted that "the distinct problems of [employees covered by the RLA] and their importance to the national economy are well recognized . . . and are highlighted by the differences between the Railway Labor Act and the National Labor Relations Act."

In enacting Section 1167 of the Bankruptcy Code, Congress recognized these differences and provided for special treatment of contracts subject to the RLA. The fact that in *Kevin Steel* and *REA Express* the Second Circuit was dealing with labor contracts governed by separate and distinct statutes may explain the different standards applied by the court in decisions rendered only one month apart.

It is also significant that the only other circuit court of appeals to rule on the issue of rejection of collective bargaining agreements under Section 365 adopted the balancing test formulated by the court below. In *In re Brada Miller Freight System, Inc.,* 702 F.2d 890, 899 (11th Cir. 1983), the Eleventh Circuit stated:

> "We agree with the *Bildisco* court, particularly with regard to its latter conclusion that the test of *REA*

> *Express* imposes an excessive burden on the debtor-in-possession, one that subordinates the myriad of diverse interests at stake to a single issue: the ability of the debtor-in-possession to show by a preponderance of the evidence that forced liquidation is a certainty absent a rejection of the collective bargaining agreement. We find, as did the *Bildisco* court, that the *Kevin Steel* balancing of the equities test provides a more satisfactory accommodation of the conflicting interests at stake in a rejection proceeding."

As both the *Bildisco* and *Brada Miller* decisions recognize, a Chapter 11 proceeding contemplates and permits the adjustment and restructuring of the rights of all creditors and shareholders in order to achieve the rehabilitation of financially distressed business entities. As stated by the Committee on the Judiciary of the House of Representatives:

> "The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend or reduce its debts, it often can be returned to a viable state. It is more eco-

> nomically efficient to reorganize than to liquidate, because it preserves jobs and assets."
>
> H.R. Rep. No. 95-595, 95th Cong., 1st Sess., 320 (1977)

The Judiciary Committee further pointed out that unlike an out-of-court settlement with creditors, a reorganization under the bankruptcy laws is binding upon nonconsenting creditors and thus permits a more substantial restructuring of a debtor's finances (*id.*).

The restructuring of the debtor's finances under a Chapter 11 plan, however, is not designed to favor the interests of one group of creditors over those of other groups. Rather, the long-standing federal policy requires that a Chapter 11 plan not unfairly discriminate among creditors. As this Court noted in *Young* v. *Higbee Co.*, 324 U.S. 204, 210 (1945), one of the prime purposes of the bankruptcy laws has historically been to ratably distribute the assets of the bankrupt among creditors, and to protect creditors from one another.

The policy of equality of treatment is embodied in several substantive provisions of Chapter 11. Sections 1122(a), 11 U.S.C. §1122(a), and 1123(a)(4), 11 U.S.C. 1123(a)(4), require that a plan of reorganization place claims of a similar nature in the same class and provide the same treatment for each claim in a particular class.[5]

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[5] Section 1122(a) provides:

> "Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class."

(Footnote continued on following page)

Similarly, Section 1129(b)(1), 11 U.S.C. 1129(b)(1), provides that a plan of reorganization should be confirmed even in the absence of acceptance by the requisite number of creditors if the court finds that the plan does not discriminate unfairly and is fair and equitable with respect to non-accepting classes.[6]

The test espoused by the Petitioners clearly runs afoul of the fundamental bankruptcy policy of requiring all creditors to share equally in the sacrifices required to achieve a successful reorganization. In many instances a debtor might be able to leave the rights of employees untouched and still avoid liquidation by requiring other classes of creditors to forfeit all or a substantial portion of their claims and interests. Requiring that other creditors accept the full brunt of economic sacrifice so that unionized employees can escape unscathed from the

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(Footnote continued from preceding page)

Section 1123(a)(4) provides:

> "(a) A plan shall—
>
> (4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;"

[6] Section 1129(b)(1) provides:

> "Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."

debtor's restructuring of its finances, however, is so contrary to the design of Chapter 11 and so manifestly inequitable that it should not be tolerated short of a clear and unequivocal expression by Congress of such an intent.

The test enunciated by the court below is expressly designed to foster financial rehabilitation but at the same time to balance the hardships to be borne by all classes of creditors. Special recognition of the rights of organized labor, however, is a fundamental element in the Third Circuit's balancing approach thus assuring that the policies underlying the NLRA are afforded sufficient protection within the context of a reorganization.

As noted in both the decision below and the opinion in *Brada Miller,* each Chapter 11 proceeding will involve its own equation of hardships and equities to be considered and balanced by the bankruptcy court to insure that the rights of particular classes of creditors, including unionized employees, are not unduly forfeited in order to achieve a successful reorganization. An inflexible rule such as that proposed by the petitioners is therefore clearly unwise and inappropriate. Rather, a requirement that the courts weigh the competing equities on a case by case basis utilizing the general guidelines established by the court below represents the most sensible and logical approach to reconciling the competing interests of organized labor, the debtor, and its creditors.

The major thrust of the Union's argument is nothing more than the contention that the rejection of a collective bargaining agreement will result in the deprivation of certain employee rights. While this is undoubtedly true, it is also true that Chapter 11, by its very nature, may result in the deprivation of rights and claims by all those who have business relations with the debtor.

In holding that a labor contract cannot be rejected merely upon a showing that such action would be beneficial to the debtor, as is the case with other executory contracts, and imposing instead the requirement that the debtor establish that the equities tip in favor of rejection and that rejection will assist the achievement of a satisfactory reorganization, the court below has assured that the rights of employees receive meaningful and substantial protection.

It is also clear that the Union vastly overstates the potential harm to employees as a result of rejection of labor agreements. Employees, in fact, are in a far better position to protect their interests than are most other creditor classes. Rejection of a collective bargaining agreement does not terminate the relationship between the union and debtor in possession. On the contrary, the debtor in possession must still recognize the union as the employees' bargaining representative and is required to negotiate with it with respect to the terms and conditions of employment. The employees retain their right to strike should negotiations fail. *In re Bildisco, supra* at 60.

Given the crippling impact of a strike on a debtor's already distressed financial condition, the union can expect that a debtor in possession will be disposed to accommodate a union's reasonable demands. In addition, the very threat of a strike will be sufficient in most instances to prevent a debtor in possession from seeking rejection unless it is convinced tht such action is essential for the survival and reorganization of its business. A stated in *Kevin Steel, supra* at 70, in a reorganization proceeding "which is designed to preserve a going business, only a hardy—some might say foolhardy—

employer would provoke a strike by trying to terminate an existing labor contract."

Further protection of employee rights is found at Section 502(c) of the Bankruptcy Code, 11 U.S.C. Section 502(c), which requires the bankruptcy court to estimate and allow even unliquidated and contingent employee claims resulting from rejection of a labor contract.[7] Indeed, the court below noted that the relief available to employees through the claims procedure was one element to be considered in balancing the equities. *In re Bildisco, supra* at 80.

The Third Circuit also correctly pointed out that the test advanced by Petitioners is impractical and unworkable given the difficulty if not impossibility of predicting with any accuracy, at least in the early stages of a reorganization case, whether rejection of a labor contract is the only alternative to liquidation. Congress has recognized that in most Chapter 11 proceedings a quick determination of the feasibility of a plan of reorganization is not possible. Thus no time limit is placed upon the debtor in which a plan must be submitted. On the contrary, Section 1121(a) of the Bankruptcy Code, 11 U.S.C. §1121(a), provides that the debtor in possession may file a plan at any time.

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[7] Section 502(c) provides:

> "(c) There shall be estimated for purpose of allowance under this section—
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> (1) any contingent or unliquidated claim, fixing or liquidation of which, as the case may be, would unduly delay the closing of the case; or
>
> (2) any right to an equitable remedy breach of performance if such breach gives rise to a right to payment."

While the Code makes reference to the requirement that a debtor file a statement of affairs and schedules of assets and liabilities at the outset of a Chapter 11 case, the information contained therein is unlikely to assist the court in analyzing the prospects of a successful reorganization. Debtors in possesion customarily utilize the breathing spell provided by Chapter 11 to substantially restructure their methods of operation in an attempt to increase efficiency and curtail losses. Even after this restructuring is accomplished it may take a protracted period of time for the results to be felt and analyzed. In addition, the very filing of a Chapter 11 petition often results in at least an initial curtailment of operating revenues, since many vendors customarily refuse to provide credit and customers may be unwilling to place orders due to their uncertainty as the debtor's ability to perform.

A debtor in possession may therefore be unable to accurately forecast its operating revenues until results of restructuring and the impact of the Chapter 11 filing become known. Any attempt to assess the impact of a collective bargaining agreement on the ability of the debtor in possession to continue to operate is virtually impossible until its operations have stabilized to the point of permitting the court to make valid findings with respect to projected operating revenues and profits. Under the test advocated by Petitioners, therefore, the debtor in possession would in many instances be unable to meet its evidentiary burden at any early stage in the proceedings and be forced to adopt a labor agreement which ultimately proves so onerous and burdensome as to render a successful reorganization impossible.

The standard adopted by the Third Circuit avoids this result while at the same time assuring that rejection of

labor contracts will not be lightly permitted and that the impact of rejection on covered employees will be given due regard in the court's determination.[8]

POINT II

Policy considerations and controlling legal principles dictate that a debtor in possession may seek permission to reject a collective bargaining agreement without first complying with the bargaining requirements for mid-term contract modification contained in Section 8(d) of the NLRA.

In addition to challenging the test formulated by the court below for rejection of labor agreements, the Union contends that as a precondition to rejection, a debtor in possession must be required to comply with the bargaining requirement for mid-term contract modification set forth in Section 8(d) of the NLRA, 29 U.S.C. §158(d). The Union argues that the effect of the Third Circuit's ruling is to free a debtor in possession from its obligation under a collective bargaining agreement merely upon the filing of a Chapter 11 petition. This argument completely misperceives the impact of the Third Circuit's decision.

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[8] The fears voiced by the Union that the test formulated by the Third Circuit will encourage solvent employers to file Chapter 11 petitions in a bad faith attempt to rid themselves of the obligations imposed by collective bargaining agreements are groundless. It is unlikely that many solvent businesses will subject themselves to the strict creditor scrutiny and court control which Chapter 11 imposes merely in an attempt to escape the terms of labor agreements. Moreover, as a court of equity, the bankruptcy court has the inherent equitable power to dismiss a Chapter 11 petition upon a finding that it has been filed in bad faith. See 11 U.S.C. §1112(b); *In re G-2 Realty Trust*, 6 B.R. 549, 552 (B. Ct. D. Mass. 1980).

The ruling of the court below was based upon the theory first articulated by the court in *Kevin Steel, supra* at 704, and reiterated in *REA Express, supra* at 171, that the debtor in possession is a "new entity created with its own rights and duties, subject to the supervision of the bankruptcy court." Because the debtor in possession is not a party to the collective bargaining agreement, it is not obligated to bargain over modifications in the terms of employment but is free to set its own initial terms and conditions.

The determination that a debtor in possession is a new entity is consistent with the provisions of the Bankruptcy Code and with generally recognized principles relating to executory contracts. Under Section 1107 of the Code, 11 U.S.C. §1107, a debtor in possession is granted rights and responsibilities equivalent to those of a bankruptcy trustee. Unlike the pre-Chapter 11 debtor, the debtor in possession cannot operate its business merely for its own benefit but is charged with a fiduciary duty towards its creditors. In managing its business the debtor in possession is also subject to the supervision of the bankruptcy court.

The power to reject executory contracts is an extension of the principle that a trustee in bankruptcy may abandon burdensome property. In order to prevent bankrupt estates from being saddled with onerous contractual liabilities, the courts developed a doctrine under which title to an executory contract did not immediately vest in the trustee, but rather vested only upon the trustee's affirmative adoption of the contract. This principle was premised on the recognition that executory contracts involve financial obligations, as well as benefits, and that the bankrupt estate should not be charged with such obligations unless they were clearly assumed by the trustee after careful deliberation. 2 *Collier on Bankruptcy*, ¶365.01, pp. 365-6-365-8 (15th ed.).

A trustee or debtor in possession does not automatically become liable to perform the terms and conditions of the debtor's executory contracts upon the filing of a reorganization petition. Rather, such a result follows only upon the trustee's or debtor in possession's affirmative adoption of a contract. *Sunflower Oil Co.* v. *Wilson,* 142 U.S. 313, 322 (1892), *In re Northern Indiana Oil Co.,* 180 F.2d 669, 675 (7th Cir. 1950), *cert. denied* 340 U.S. 883; *Pacific Western Oil Co.* v. *McDuffie,* 69 F.2d 208, 213 (9th Cir. 1934), *cert. denied* 203 U.S. 568; *In re Rochester Shipbuilding Corp.,* 32 F.Supp. 98 (W.D.N.Y. 1940). The trustee or debtor in possession is afforded this breathing spell for the express purpose of protecting the bankrupt's estate from claims arising from a failure to perform subsequent to the date of filing. *In re McCormick Lumber & Mfg. Corp.,* 144 F.Supp. 804, 805 (D.Or. 1956).

The Union's argument that the effect of the Third Circuit's ruling is to release the debtor in possession from the obligations imposed by a collective bargaining agreement upon the filing of a Chapter 11 petition clearly misconstrues the controlling law. The filing of the petition itself does not terminate a labor agreement, but as in the case with other executory contracts, places it in a period of suspension pending the debtor in possession's decision to seek assumption or rejection.[9]

The debtor in possesion's initial freedom from complying with the terms of a collective bargaining agreement strongly supports the validity of the analogy drawn by the Third Circuit between a debtor in possession and a successor employer. Citing this Court's holding in *NLRB* v.

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[9] The effect of assumption or rejection on rights accruing under a collective bargaining agreement in this interim period are discussed at Point III, *infra.*

Burns Security Services, Inc., 406 U.S. 272 (1972), the Third Circuit concluded that, as in the case with a successor employer, a debtor in possession may be required to recognize and bargain with the union, but is not a party to the agreement unless it affirmatively assumes the labor contract.

In *Burns, supra* at 287, this Court rejected the argument of the NLRB that a successor employer is necessarily bound by the substantive terms and conditions of its predecessor's collective bargaining agreement. In holding that the successor employer in that case was not so bound, the Court emphasized that nothing in the new employer's actions indicated that it was assuming the obligations of the contract.

The Court further noted that a successor must be free to set the initial terms and conditions of employment in order to promote rehabilitation of failing businesses. As stated at pages 287-288 of the *Burns* decision:

> "A potential employer may be willing to take over a moribund business only if he can make changes in corporate structure, composition of the labor force, work location, task assignment, and nature of supervision. Saddling such an employer with the terms and conditions of employment contained in the old collective-bargaining contract may make these changes impossible and may discourage and inhibit the transfer of capital."

The analogy between a debtor in possession and a successor employer was applied by the Second Circuit in the *Kevin Steel* decision, *supra* at 704. In *REA Express, supra* at 170-171, the Second Circuit made the same analogy and expounded its rationale. Pointing out that

the *Burns* decision was premised on policy considerations designed to encourage efforts to revive failing business enterprises, the court noted that these considerations were particularly applicable to the efforts of a trustee or debtor in possession to stave off liquidation. Automatically imposing onerous employment conditions on the debtor in possession pending the protracted negotiations required by the labor laws would, the Court pointed out, undoubtedly force many financially distressed enterprises out of business, terminating the jobs of all of its employees.[10]

In *Local Joint Executive Board* v. *Hotel Circle, Inc.*, 613 F.2d 210, 214 (9th Cir. 1980), the Ninth Circuit also found the successorship analogy persuasive. The court noted that the policy of allowing a debtor in possession a new start "provides an even stronger reason for not automatically imposing the existing labor agreement than does the policy recognized in *Burns* of encouraging the free flow of capital."

The Petitioners correctly point out that the *Burns* holding does not foreclose the imposition of the substantive terms of a predecessor's collective bargaining agreement upon the successor employer in all cases. As this Court indicated at page 291 of the *Burns* decision, in certain circumstances the Board might find as a matter

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[10] Imposing the terms of a collective bargaining agreement on a debtor in possession in circumstances where a successor employer would not be bound would also encourage existing ownership to sell the business rather than to accomplish its reorganization under Chapter 11. The result is directly at odds with the policy of promoting the rehabilitation of existing businesses and is highly prejudicial to shareholders of ailing business enterprises who would be forced to sell their interests, presumably at a distress prices, rather than to attempt to accomplish its reorganization.

of fact from the successor's conduct that it has assumed the predecessor's obligations under the predecessor's labor contract. The Court was careful to point out that "[s]uch a duty does not, however, ensue as a matter of law from the mere fact that the employer is doing the same work in the same place with the same employees as his predecessor."

In *Howard Johnson Co., Inc.* v. *Detroit Local Joint Executive Board,* 417 U.S. 249, 256 (1974) this Court considered whether a successor employer was required to arbitrate the extent of its obligations to the predecessor's employees. Finding that no such duty existed, the Court again emphasized the appropriateness of a case-by-case approach to the issue of a successor's liability and indicated that, in addition to the factual circumstances of each case, the legal context in which it arises is an important consideration.

The principles espoused in the *Burns* and *Howard Johnson* decisions underscore the invalidity of the Petitioners' assertion that, because a debtor in possession normally conducts the same work as the debtor and employs the same work force, it should be bound by the terms of the debtor's collective bargaining agreement. These decisions make clear that the identity of work performed and composition of the work force does not, as a matter of law, bind a successor to the obligations arising under a labor agreement. Such liability will only be imposed if the factual circumstances and the legal context of a particular case warrant the conclusion that the successor either expressly or by its conduct has assumed its predecessor's agreement.

In the legal context of a Chapter 11 proceeding, the conclusion that a debtor in possession has by its conduct

assumed the terms of the debtor's labor contract will rarely be justified. Section 365(g)(1) of the Bankruptcy Code expressly prohibits a debtor in possession or trustee from tacitly approving an executory contract. The statute is clear that asumption of such agreements can only be accomplished with the formal approval of the bankruptcy court. See *In re Price Chopper Supermarkets, Inc.*, 19 B.R. 462, 466-67 (B.Ct. S.D. Cal. 1982).

Even the trustee's partial performance of his obligations under an executory agreement is not sufficient to bind him, absent court approval. As stated in *Pacific Western Oil Co.* v. *McDuffie, supra* at 213, a trustee may, with court approval, perform some part of an executory contract on an experimental basis pending his decision to adopt or reject it. In order for the trustee to become bound by the contract, however, he must positively assume it under the direction of the court.

The fact that a debtor in possession is not required to comply with Section 8(d) of the NLRA prior to seeking permission to reject a labor agreement does not leave a union powerless to protect its members' interests. A debtor in possession is an "employer" under the express terms of Section 2 of the NLRA, 29 U.S.C. §152, and, as the court below noted, is required to recognize and bargain with the union over the terms and conditions of employment. The employees may strike should negotiations fail.

A union also need not wait indefinitely for a debtor in possession to make an election as to assumption or rejection. Under Section 365(d)(2) of the Bankruptcy Code a union has the right to request that the bankruptcy court establish a time certain by which a debtor in possession must move to assume or reject a collective bargaining agreement.

Public policy considerations militate so strongly against requiring a debtor in possession to comply with Section 8(d) that even the NLRB is forced to disagree with the Union on this point. As the Board notes, requiring strict compliance with the formal notice provisions and waiting periods contained in Section 8(d) would prevent a debtor in possession from seeking prompt rejection of a collective bargaining agreement even in those cases where adherence to the contract presents an imminent threat to the survival of the debtor's business. A debtor in possesssion must be free to move for rejection at the earliest possible date, and to set the initial terms of employment in order to insure that its right to reject is not rendered moot because the burdens imposed by the contract itself have forced the debtor into liquidation.[11]

Rather than imposing upon the debtor in possession the absolute obligation to bargain before seeking rejection, the sounder approach is to treat the willingness of the debtor in possession to bargain as one factor to be considered in balancing the equities when a debtor in possession applies for authorization to reject a labor agreement. This approach was explicitly sanctioned by the decision below which held that "the good or bad faith of the parties in dealing with the effect of the company's insolvency on its labor obligations" is among the factors bankruptcy courts might

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[11] Reference to Section 1167 of the Bankruptcy Code leads to the conclusion that Congress itself rejected the position advanced by the Union. This statute prohibits a bankruptcy trustee from changing the wages and working conditions of employees covered by the Railway Labor Act, except in accordance with the bargaining requirements contained in that statute. The failure of Congress to impose a similar prohibition with respect to employees covered by the NLRA indicates its decision not to require compliance with Section 8(d) as a pre-condition to rejection.

consider in balancing the equities. *In re Bildisco, supra,* at 80, n. 12.

In adopting an approach virtually identical to that of the court below, the Eleventh Circuit in the *Brada Miller* decision, *supra,* also refused to require a debtor in possession to commence the bargaining process prior to seeking rejection. The *Brada Miller* court also deemed it more prudent to treat the good faith of the debtor (and the union) as one factor to be considered in deciding an application to reject.

The Union alternatively proposes that a debtor in possession's efforts to negotiate with a union be deemed a "central and crucial consideration to be accorded substantial weight." This proposal is as ill-conceived as the imposition of Section 8(d) obligations. In weighing the competing equities, the bankruptcy court must be free to adopt a flexible approach capable of responding to the unique factual pattern which each application will present. Arbitrarily elevating one factor over all other pertinent considerations would unduly restrict the ability of the court to fashion a remedy appropriate under the particular facts and circumstances of each case.

POINT III

Because rejection of a collective bargaining agreement relates back to the date of the Chapter 11 petition, upon the entry of an order permitting rejection the Board is foreclosed from finding that a debtor in possession has committed an unfair labor practice by unilaterally changing terms and conditions of employment.

In appeal No. 82-818, the NLRB seeks review of the Third Circuit's denial of its application for enforcement of the order determining that the debtor in possession had violated Sections 8(a)(1) and 8(a)(5) of the NLRA, 29 U.S.C. §§158(a)(1) and 158(a)(5), by unilaterally changing the terms and conditions of employment. The court held that as a matter of law the debtor in possession is a new entity not a party to the labor agreement and thus not subject to its terms. Moreover, rejection of an executory contract relates back to the date of the filing of the Chapter 11. If on remand the bankrupcty court permits rejection, the court concluded that the Board will be bound by the determination that no labor contract existed subsequent to the Chapter 11 filing.

The Board premises its theory that a debtor in possession must adhere to the terms of an existing collective bargaining agreement on the conclusion that a debtor in possession is a mere "alter ego" of the debtor (NLRB's brief at 36-40). The alter ego theory, however, is totally inappropriate in the context of a Chapter 11 proceeding. As this Court noted in *Howard Johnson Co., Inc.* v. *Hotel Employees, supra* at 259 n. 5, a new employer will be deemed the "alter ego" of its predecessor when it is "merely a disguised continuance of the old employer" (citing *Southport Petroleum Co.* v. *NLRB,* 315 U.S. 100, 106 (1942)). As the Court further stated:

> "Such cases involve a mere technical change in the structure or identity of the employing entity, frequently to avoid the effect of the labor laws, without any substantial change in its ownership or management. In these circumstances, the courts have had little difficulty holding that the successor is in reality the same employer and is subject to all the legal and contractual obligations of the predecessor. [citations omitted]"

The designation of a trustee or debtor in possession in a Chapter 11 case involves far more than a mere "technical change" in the structure and identity of the employer. On the contrary, it represents the replacement of the former employer by a fiduciary charged with administering the assets of the estate for the benefit of creditors and subject to the control of the court. A trustee or debtor in possession is armed with many legal rights and is subject to many legal obligations and controls totally new and distinct from the rights and duties of the pre-bankruptcy company. Among these rights are the power to avoid preferential and fraudulent transfers, even if made or permitted by the pre-bankruptcy entity (11 U.S.C. §§547, 548), the rights of a lien creditor and a bona fide purchaser of real property (11 U.S.C. §544), the right to avoid certain statutory liens (11 U.S.C. §545), the right to abandon burdensome property (11 U.S.C. §554) and the very right here at issue to reject executory contracts.

Among the restrictions imposed upon a trustee or debtor in possession are the requirements to obtain court approval for the retention of professionals (11 U.S.C. §327), for the use, sale or lease of property other than in the ordinary course of business (11 U.S.C. §363), and for obtaining credit (11 U.S.C. §365).

Although a debtor in possession may be operated by the same management as the pre-bankruptcy company, its rights and duties are so altered by the filing of the Chapter 11 petition that the new entity theory adopted by the court below correctly describes its legal status, at least in the context of its rights with respect to executory contracts.[12]

The Board's contention that a debtor in possession commits unfair labor practices by changing the terms and conditions of employment is necessarily premised on the assumption that a debtor in possession is bound by the provisions of the debtor's collective bargaining agreement until the contract is rejected. As pointed out at Point II, *supra*, this proposition is totally contrary to controlling law. The filing of a Chapter 11 petition places executory contracts in suspension to afford the debtor in possession a reasonable period of time in which to evaluate whether the benefits conferred by the contract outweigh the burdens. Prior to adoption of the contract a debtor in possession is not required to perform its terms.

A logical and necessary corollary of this principle is that when rejection is permitted, it is deemed to relate back to the date of the filing of the Chapter 11 petition. Section 365(g)(1) of the Bankruptcy Code, 11 U.S.C. §365(g)(1) expresses this result by declaring that disaffirmance of a

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[12] Contrary to Petitioner's assertion, there is no logical inconsistency in holding on the one hand that a debtor in possession is not bound by the collective bargaining agreement and on the other that it has the right to apply for rejection or assumption of the contract. Such a proposition is entirely in accord with the long-standing judicial doctrine, analyzed at Point II, *supra*, that while the filing of a reorganization petition does not terminate an executory contract, it does suspend its enforcement pending the trustee's decision to assume or reject.

contract constitutes a breach immediately before the date of the filing of the petition. If an executory contract is successfully rejected, therefore, the debtor in possession is relieved from performing all contractual obligations arising subsequent to the date of the Chapter 11 petition. The other party to the contract cannot enforce contractual liabilities against the estate but is limited to filing a claim as a general creditor for damages stemming from the rejection. *In re North Atlantic and Gulf Steamship Co.*, 204 F.Supp. 899, 909 (S.D.N.Y. 1962), *aff'd sub nom. Schilling* v. *A/S/D/S Dannebrog*, 320 F.2d 628 (2d Cir. 1963); *In re McCormick Lumber & Mfg. Corp supra* at 805 (D.Or. 1956); *In re Price Chopper Supermarkets, Inc.*, 19 B.R. 462, 467 (B.Ct. S.D. Cal. 1982); *In re Rovine Corp.*, 6 B.R. 661, 666 (B.Ct. W.D. Tenn 1980); *In re Middleton*, 3 BR. 610 (B. Ct. E.D. Pa. 1980).

This is not to say that the other party to the contract is not entitled to compensation for any performance on its part in the interim period between the Chapter 11 filing and the date of rejection. Because a debtor in possession is not bound by the contract unless it is adopted, however, the right to receive compensation for benefits conferred is not based upon the debtor in possession's contractual liabilities but instead is an equitable right based upon the reasonable value of the benefits conferred. *Philadelphia Co.* v. *Dipple*, 312 U.S. 168, 174 (1941); *In re Fredrick Meats, Inc.*, 483 F.2d 951, 952 (9th Cir. 1973); *American A. & B. Coal Corp.* v. *Leonardo Arrivabene, S.A.*, 280 F.2d 119, 124 (2d Cir. 1960); *In re Chicago Rapid Transit Co.*, 129 F.2d (7th Cir. 1942), *cert. denied* 317 U.S. 683; *In re United Cigar Stores Co.*, 69 F.2d 513, 515 (2d Cir. 1934), *cert. denied* sub nom.; *Reisinwebers, Inc.* v. *Irving Trust Co.*, 293 U.S. 566; *In re Price Chopper Supermarkets, Inc., supra* at 467.

The principle that rejection of an executory contract is retroactive to the date of the Chapter 11 is clearly required to give effect to the policy considerations upon which the entire doctrine of rejection is based—the recognition that a bankrupt estate should not be burdened with contractual obligations which outweigh the benefits to be derived from the contract. The Board's contention that a debtor in possession is bound by the terms of an existing labor agreement until the contract is disaffirmed subverts this policy and would impose upon the debtor in possession the very burdens Section 365 is designed to remove.

Congress and the courts have also recognized that a debtor in possession requires a reasonable period of time to properly evaluate whether assumption of an executory contract is in the best interest of the estate. In contrast to Section 365(d)(1) of the Bankruptcy Code, 11 U.S.C. §365(d)(1), which provides that in a Chapter 7 liquidation proceeding an executory contract will be deemed rejected sixty days after the filing of a petition unless the trustee assumes it, Section 365(d)(2) provides that a trustee may assume or reject a contract at any time prior to confirmation of a plan. See also, 2 *Collier on Bankruptcy*, ¶365.03, p. 365.20 (15th ed.).

The financial pressure exerted on a debtor in possession by the continuing accrual of contractual obligations during the period in which it is evaluating the benefits and burdens of a collective bargaining agreement would severely impede the debtor in possession's ability to make a reasoned and prudent judgment as to the value of the contract. Such pressure is likely to result in the early rejection of numerous labor contracts which would otherwise have been assumed had the debtor in possession been free to deliberate in an unhurried fashion.

As the above analysis makes clear the entry of an order authorizing the rejection of a collective bargaining agreement results as a matter of law in the determination that the debtor in possession was not bound by the agreement subsequent to the filing of the Chapter 11 petition. The NLRB in such circumstances is thus foreclosed from finding that the debtor in possession's unilateral changes in the terms and conditions of the agreement constitute an unfair labor practice.[13]

Neither the debtor in possesssion's initial freedom to fix the terms and conditions of employment nor the retroactive effect of an order authorizing rejection of a labor contract results in the drastic prejudice to employee rights envisioned by the Petitioners. Although not bound by the terms of a pre-existing collective bargaining contract, the debtor in possession is nevertheless obligated to recognize its employee's union and bargain in good faith over the terms and conditions of employment. Thus the union is free, immediately upon the filing of an employer's Chapter 11 petition, to demand that the debtor in possession commence the bargaining process.

Even if the debtor in possession takes no immediate steps to alter the terms and conditions of employment, only the most sanguine union representative will be led to conclude that the employees may not at some point in the proceedings be called upon to sacrifice certain rights and bene-

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[13] The result is quite different when a collective bargaining agreement is assumed. Assumption, like rejection, is deemed retroactive to the date of the Chapter 11 petition and by assuming an executory contract a debtor in possession obligates itself to fully perform all of the terms of the contract as if bankruptcy had not intervened. *American A. & B. Coal Corp.* v. *Leonardo Arrivabene, S.A., supra* at 124; *In re Italian Cook Oil Corp.*, 190 F.2d 994, 996-7 (3d Cir. 1951).

fits in order to render a successful reorganization possible. The filing of the Chapter 11 petition itself should serve as a clear signal to the employees and their bargaining representatives that changes in the terms and conditions of employment may well be sought by the debtor in possession. See *B.R.A.C.* v. *REA Express, Inc., supra,* at 171. A union which chooses to bury its head in the sand rather than to aggressively pursue negotiations with the debtor in possession as to post-Chapter 11 terms of employment has no legitimate complaint that its members continued to work in reliance upon the belief that the debtor in possession would adhere to the terms of the collective bargaining agreement.

The debtor in possession is not free to unilaterally control the timing of its election to assume or reject a labor agreement. Unions and the Board have the right to apply to the court pursuant to Section 365(d)(2) of the Bankruptcy Code, 11 U.S.C. §365(d)(2), for an order requiring the debtor in possession to make such a determination within a specified period of time.[14] By diligently pursuing its right to negotiate and, if necessary, by seeking relief pursuant to Section 365(d)(2) a union has ample means to protect the interests of its membership.

Even in those cases in which protracted period elapses between the Chapter 11 filing and the entry of an order permitting rejection of a collective bargaining agreement, the retroactive effect of rejection does not deprive covered employees of their right to just compensation for services rendered. Employees performing work during a reorgani-

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[14] In determining what constitutes a reasonable period of time, the factors to be considered include the nature of the interests at stake, the balance of harm, the good to be achieved and the safeguards to the parties. *Theatre Holding Corp.* v. *Mauro,* 17 B.R. 430, 431 (S.D.N.Y. 1980), aff'd 681 F.2d 102 (2d Cir.).

zation are entitled to receive compensation based upon the fair market value of the services provided. If wages and benefits paid by the debtor in possession are determined to be less than fair, the employees have the right to assert claims for the true value of their services, which claims will be accorded first priority treatment as costs of administration. *In re Capital Service,* 136 F.Supp. 430, 438 (S.D. Cal. 1955); *In re Price Chopper Supermarkets, Inc., supra* at 467.

The specter of employees continuing to work for a debtor in possession only to find that they will not be adequately compensated for their services following a rejection of their labor contract vanishes when exposed to the light of these controlling legal principles. As a court of equity, the bankruptcy court has the duty and power to insure fair treatment to employees of the debtor in possession.

CONCLUSION

For all of the foregoing reasons it is respectfully submitted that the judgment of the Court of Appeals in these matters should be affirmed in all respects.

Respectfully submitted,

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